United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL 75-7387

United States Court of Appeals

For the Second Circuit.

Superintendent of Insurance of the State of New York, as Liquidator of Manhattan Casualty Company,

Plaintiff-Appellee,

v.

Bankers Life and Casualty Company, Irving Trust Co., Belgian American Banking Corporation, Belgian American Bank & Trust Company, Garvin Bantel & Company, New England Note Corporation, The Estate of George K. Garvin by Ruth N. Garvin, The Estate of James P. Begole, by Patricia C.R. Begole, as Executrix, John F. Sweeney, The Estate of Standish T. Bourne, by Standish T. Bourne, Jr.,

Defendants-Appellees,

and

Harry Berg nd Florence H. Brandenburg, Executrix,

Intervenors-Objectors-Appellants.

Appellants' Brief

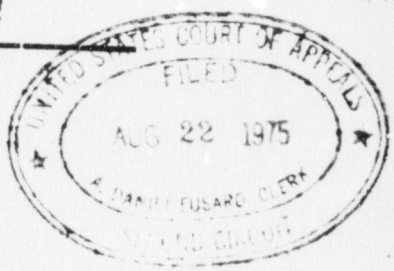

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TABLE OF CONTENTS

Cases Cited

Other Authorities

UNITED STATES COURT OF APPEALS
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Defendants-Appellees,

-and-

Harry Berg and Florence H. Brandenburg, Executrix,

Intervenors-Objectors-Appellants.

Brief for Intervenors-Objectors-Appellants

Appeal by intervenors-objectors-appellants ("appellants") from an order of the District Court for the Southern District of New York (Charles L. Brieant, Jr. J), made on June 16, 1975 and filed on June 17, 1975. The order below denied a motion by appellants for an order:

1. Granting Harry Berg, on behalf of all creditors of Manhattan Casualty Company ("MCC"), Florence H. Brandenburg, Executrix of the Estate of Matthew H. Brandenburg, as sole stockholder of MCC, and Harry Berg and Florence H. Brandenburg, on behalf of the taxpayers of the State of New York, leave to intervene for the purpose of protecting the rights of MCC, its creditors, the sole stockholder of MCC, and the taxpayers of the State of New York.

2. Enjoining the parties to the within Federal action, from interposing in the action, any defense based upon the judgment entered in the New York State Supreme Court, which approved

the settlement of the Federal action and authorized its dismissal;

3. Enjoining the parties from releasing the defendants, on behalf of MCC, from the claims asserted in the Federal action on behalf of MCC;

4. Granting Appellants the right to amend the complaint in the District Court to asert, as a pendent claim, the claim asserted in the Supreme Court of the State of New York, County of New York, Index No. 11358/65;

5. Determining that the State Supreme Court had no jurisdiction to pass upon the fairness and reasonableness of the settlement and that the judgment of that court is a nullity insofar as the action in the District Court is concerned;

6. Determining that in the State Court, MCC, the creditors of MCC, the sole stockholder of MCC, and the taxpayers of the State of New York were deprived of procedural and substantive due process;

7. Disapproving the settlement agreement made as of June 8, 1972.

Appellants are: (a) Harry Berg, a creditor of MCC, acting on behalf of all creditors of MCC, and (b) Estate of Matthew H. Brandenburg, the sole stockholder of all of the stock of MCC. The objectors also act on behalf of the taxpayers of the State of New York.

FACTS

In January 1962, MCC was a New York insurance corporation whose stock was one hundred percent privately owned by Bankers Life and Casualty Company ("Bankers Life").

Commencing on January 24, 1962, Irving Trust Company, ("Irving Trust"), Belgian American Banking Corporation ("BA Banking"), and Belgian Bank & Trust Company, ("BA Trust"), among others, engaged in a series of transactions which started with the sale of all of MCC's stock to one Begole on January 24, 1962 and ended with an investigation of these transactions by the Supt. of Insurance in 1963. The Supt. concluded that, as a result of these transactions, MCC had been despoiled of its assets and was insolvent. The Supt. thereupon moved in the Supreme Court, New York County for an order permitting the Supt.

forthwith to take possession of the property of MCC, to liquidate its business and affairs, and to dissolve its charter. The order was granted on May 24, 1963.

Among the assets of MCC, was a lawsuit against those who had despoiled MCC of its assets by participating in the despoiling transactions. On August 19, 1963, the Supt. commenced an action *on behalf of MCC* against all those who had participated in the transactions. The action was commenced in the US District Court for the Southern District of New York and was predicated upon an alleged violation of Sec. 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) ("Exchange Act") and SEC Rule 10b-5 thereunder (17 CPR Sec. 240.10b-5).

The case in the District court was vigorously prosecuted and went as far as the United States Supreme Court. On November 8, 1971, the United States Supreme Court held that the complaint stated a good cause of action under Sec. 10(b) of the Exchange Act (*Supt. of Insurance v. Bankers Life*, 404 US 6).

On July 23, 1965, two years after the commencement of the federal action, the Supt. commenced another action in the Supreme Court, New York County. This action was based upon the same facts as the Federal case, but instead of being predicated upon Sec. 10(b) of the Exchange Act, it pleaded common law fraud, conversion and negligence. As shown by the State Court Docket book, virtually nothing was done in the state court case until August 15, 1972 when the Supt. made an application to the State Court for leave to settle and compromise *both actions*.

Appellant Estate of Brandenburg, the 100% sole stock holder of MCC, and Appellant Berg, on behalf of the creditors of MCC, intervened to oppose the settlement. In addition to claiming that the proposed settlement was unreasonable and inadequate, the objectors claimed that the state court lacked jurisdiction to pass upon the exclusively federal claim predicated upon Sec. 10(b) of the Exchange Act.

The application came on before Justice Jacob Markowitz who overruled the objectants' challenge to the jurisdiction of the court, and held that a referee should be appointed to hear and report on the fairness of the settlement.

The Hon. Samuel M. Gold, a former Justice of the State

Supreme Court, was appointed as referee to hear and report on the fairness of the settlement, and a "hearing" was held before him. On June 4, 1973, the Referee submitted his report which recommenced that the Supt. be authorized to make the settlement. Upon motion of the Supt. to confirm the report of the Referee, the Justice Markowitz, over the objection of the appellants, authorized the Supt. to settle and compromise *both the State and Federal actions.* In connection with their objection to the motion to confirm the report of the Referee, the appellants renewed their argument that the State Court did not have jurisdiction to authorize the settlement of the Federal action. Justice Markowitz again overruled the jurisdictional contention of the appellants.

Appellants' appeal to the State Appellate Division was unanimously affirmed without opinion. Appellants thereupon moved in the State Court of Appeals for leave to appeal. That motion was denied on Feb. 12, 1975.

In the meantime, on Nov. 19, 1974, the appellants had filed in the District Court action, a Notice stating that they intended, on behalf of MCC, the creditors of MCC, the sole stockholder of MCC and the Taxpayers of the State of New York, to object to any settlement or dismissal of the Federal Action pursuant to any order of the State Court. Pursuant to said Notice, Judge Charles L. Brieant, to whom the Federal case has been assigned, requested counsel to appear before him on Jan. 27, 1975. As a result of the proceedings which took place on January 27, 1975, Judge Brieant requested that the appellants make a formal motion. Accordingly, on or about Feb. 6, 1975, the appellants made a motion returnable before Judge Brieant on Feb. 25, 1975 which is the subject of the within appeal.

By order dated June 16, 1975, filed on June 17, 1975, Judge Brieant denied appellants' motion in all respects. This is the order from which appellants appeal.

Basically, Judge Brieant's order authorizes and permits the Supt. to settle and discontinue the Federal action *pursuant to the approval granted by the order of the State Supreme Court.* The order was predicated upon a decision rendered by Judge Brieant on June 3, 1975 and filed on June 4, 1975 (A-5).

In reaching the conclusion that the Supt. should be authorized and permitted to settle and discontinue the Federal action,

Judge Brieant "put aside any consideration of the merits of the settlement (A-17). He assumed "that the settlement to be made is improvident and inadequate, and that movants are aggrieved thereby" (A-18). He also assumed that "the public treasury of the State was adversely affected by the failure of the Superintendant to collect money from the defendants." (A-18). Essentially, Judge Brieant determined that the State Court had jurisdiction and power to approve the settlement of the Federal case and cause its dismissal even if the State Court made a mistake in doing so; even though the determination of the State Court deprived MCC, its sole stockholder, its creditors, and the New York Taxpayers of substantial rights; and even though the settlement was improvident, and inadequate and aggrieved the appellants (A-18). His conclusion was predicated upon the premise that "no federal interest exists which requires this court to override that determination" (A-23). He reached this conclusion despite the fact that the action in the Federal court is predicated upon a violation of Sec. 10(b) of the Exchange Act, and Sec. 27 of that Act (15 USC Sec. 78 aa), gives "exclusive jurisdiction" of violations of said Act to the U.S. District Courts.

The nub of Judge Brieant's conclusion is that the Supt. is a state fiduciary appointed by the State Court to liquidate MCC, that the interest at stake in the liquidation of MCC is exclusively a state interest; that the State Court had the exclusive power to enforce this state interest even if the State Court was wrong and deprived MCC, its sole stockholder, its creditors and the New York Taxpayers of substantial rights; that the exclusively state interest overrode the exclusively Federal Sec. 10(b) interest (A-23).

Not only did appellants claim in the court below that the State Court had no power or jurisdiction to authorize the settlement of the exclusively Federal Sec. 10(b) action, but as well, that the State Court had violated the constitutional due process rights of MCC, its creditors, its sole stockholder and the tax payers of New York, by providing a colorable hearing in form which lacked the basic essentials of due process. Judge Brieant determined that "the procedures followed in the state court were not so erroneous as to constitute a denial of due process rising to constitutional dimensions" (A-28). He further held that even if the State Court had deprived the appellants of constitutional due process, the proper procedure for appellants, was to apply to the

US Supreme Court for certiorari from the final State Court determination approving the settlement, and since the appellants had not petitionered for certiorari, the Federal Court lacked jurisdiction to determine the constitutional violations claimed by the Appellants.

QUESTIONS PRESENTED

1. Did the State Court have jurisdiction to pass upon the fairness and reasonableness of the settlement of the exclusively Federal claim predicated upon the defendants' violation of Sec. 10(b) of the Exchange Act and Rule 10b-5 thereunder?

2. Can the determination of The State Court authorizing the Supt. to settle the exclusively Federal Sec. 10(b) claim in the Federal Court, be used in the Federal Court to justify a dismissal of the Federal action without any hearing in the Federal Court, on the merits, as to the fairness of the settlement?*

3. (a) Does the Federal Court have jurisdiction to review appellants' claimed due process violations by the State Court?

(b) Did the State Court violate the constitutional rights of MCC, its creditors, the sole stockholder of MCC, and the taxpayers of the state of New York?

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*In the court below, the appellants argued that, on the basis of the applicable legal standards for obtaining judicial approval of settlements, the $1,000,000 settlement of MCC's Sec. 10(b) claim in light of a virtually assured recovery of no less than $8,000,000, and potentially between $8,000,000 and $15,000,000, is unfair and unreasonable since Judge Brieant "put aside any consideration of the merits of the settlement," by assuming that the settlement is "improvident and inadequate, and that movants are aggrieved thereby." We do not, in this brief, argue the merits of the settlement because the predicate of Judge Brieant must be assumed in this Court.

POINT I

THE STATE COURT HAD NO POWER OR JURISDICTION TO AUTHORIZE THE SUPT. TO SETTLE THE EXCLUSIVELY FEDERAL SEC 10(b) ACTION

The law is well established that a court cannot authorize the settlement of an action unless it first weighs the probabilities and possibilities of victory at a trial against what is being proposed in settlement.

State of West Virginia v. Chas Pfizer & Co., 314 F. Supp. 710, 740-741 (SD, NY, 1970) affd 440 F 2d 1079, 1085 (CA 2, 1971)
Zerkle v. Cleveland Cliffs Iron Co., 52 FRD 151, 159-160 (SD, NY, 1970)
Percodani v. Riker-Maxson Corp., 50 FRD 473 (SD, NY, 1970)
Winkelman v. General Motors, 48 F. Supp. 490, 493 mod 48 F. Supp. 500 (SD NY, 1942)

It necessarily follows that if a court is powerless to weigh either one of these elements, it is powerless to evaluate the fairness of a settlement and hence to give it valid legal sanction by its approval.

The Appellees argue that the Federal court is foreclosed from considering the merits of the settlement made by the Supt., because former State Court Justice Gold, sitting as a referee, recommended that the Supt. be authorized to settle the exclusively Sec. 10(b) claim in the Federal court; because State Court Justice Markowitz confirmed and approved this recommendation; because five justices of the State Court Appellate Division affirmed the determination of Justice Markowitz without opinion; and because seven judges of the State Court of Appeals refused to grant the appellants leave to appeal thereto. The essence of the appellees' argument is that the Federal court must or should follow the lead of the State Court justices.

The essence of the determination of Judge Brieant is that the Federal court must accept the determination of the State Court justices without considering the merits, even though the State Court determination might have been wrong, and even though

the settlement "is improvident and inadequate, and . . . - movants are aggrieved thereby." (A-17-18).

This goes to the nub of the issue before this court.

The United States Supreme Court has held that the complaint in the Federal case states a good claim under Sec. 10(b) of the Exchange Act. This is the claim upon which the Supt. relied as presenting the greatest potential of recovery for MCC. So important did the Supt. believe the assertion of this claim to be, that he went as high as the United States Supreme Court in order to establish that his complaint asserted a good claim on behalf of MCC under the Exchange Act

Sec. 27 of the Exchange Act (15 USC Sec. 78aa) provides for jurisdiction of actions for violations of this Act. It gives "exclusive jurisdiction" of violations of the Exchange Act to the US District Courts. The relevant language reads as follows:

> "Sec. 27. The district courts of the United States . . . shall have *exclusive jurisdiction* of violations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or rules and regulations thereunder" (underscoring ours).

Both the Federal Court and the New York State Court of Appeals, have held that Sec. 27 means exactly what it says. By said section, Congress has preempted for the Federal courts, jurisdiction over all actions involving violations of the Exchange Act of 1934, with the result that state courts do not have jurisdiction over actions thereunder or the right to act with respect thereto.

> *Lecor v. US Dist. Ct.*, CCH Fed. Sec. Rep., Current Vol., Par 94, 774, P 96,564 (CA 9, 1974)
> *American Distilling Co. v. Brown*, 295 NY 36 (1945).

Since Congress has taken away from the State Court the power to determine MCC's right of recovery under Sec. 10(b) at a trial, it necessarily follows that Congress has taken away from the State Court the right to weigh the probability and possibility of a recovery at a trial in connection with a proferred settlement. The power to approve a settlement can only exist if there is power to decide the case at a trial. Since the power to determine MCC's probability and possibility of Sec. 10(b) recovery at a trial is a vitally important ingredient in determining the fairness of the

settlement of the Sec. 10(b) case, the State Court had no power to pass upon the settlement.

There is a good reason why Congress pre-empted the Federal courts as the exclusive tribunals for the determination of Sec. 10(b) violations. Sec. 10(b) actions are a special breed requiring vast experience in their interpretation. The essential elements of a Sec. 10(b) claim differ substantially from those of common law fraud.

> *Lewis v. Marine Midland Grace Trust Co.*, 1973 CCH Fed Sec Law Rep Par 94,206 P 94,876, 94885 (SD NY, 1973)

As stated by the court in Lewis at 1973 CCH Fed Sec Law Rep, Par 94,206, P 94876, 94885:

> "The plaintiffs' claims under Section 10(b) and Rule 10b-5 are cognizable only in the federal district courts. Securities Exchange Act of 1934 Section 27, 15 U.S.C. Section 78aa (1970). *Abramson v. Pennwood Investment Co.*, 392 F. 2d 759, 762 (2d Cir. 1968). Additionally, the essential elements of a claim of a violation of the securities laws differ substantially from those of common law fraud. See, e.g., *Wellington Computer Graphics, Inc. v. Modell*, 315 F. Supp. 24, 26 (S.D.-N.Y. 1970); I.A. Bromberg, Securities Law; Fraud Section 2.7, at 55-58 (1967)."

The intricacies of the federal law involving Sec. 10(b), as well as the time, effort and expense expended by the Supt. in the case at bar to establish that the federal action stated a Federal cause of action under Sec 10(b), are best exemplified by the history of the federal action as described in the case of *Karvelas v. Sellas*, Current CCH Fed Sec Law Rep Par 94,801 P 96,662, 96,664-96,665 (DC, ND ILL, 1974).

In the case at bar, the only justices who authorized the settlement of the exclusively Federal Sec 10(b) case were State Court justices who, with all respect, have absolutely no experience concerning Sec 10(b) claims and know nothing about them. Congress has decreed that State Court justices are not qualified to determine Sec 10(b) actions. The history of Sec 10(b) litigation—as well as the federal case at bar—reveals how Federal judges given exclusive jurisdiction have been struggling

with the law involving Sec 10(b) claims. In this circumstance, it is ironic that Judge Brieant held that the Federal court is bound by the State Court's "evaluation" of the Sec 10(b) claim and has no power to consider the fairness of the settlement on its merits because "no federal interest exists which requires this court to override that determiantion." (A-23). The irony is compounded by the assumption of Judge Brieant "that the settlement to be made is improvident and inadequate, and that movants are aggrieved thereby." (A-18). It is further compounded by the fact that Judge Brieant's determination, contrary to the direction of Congress which has given exclusive jurisdiction over Sec 10(b) claims to the Federal courts, in effect has given exclusive jurisdiction of the Sec 10(b) claim involved in the case at bar, to the State Court. Since the law is well established that a court cannot authorize the settlement of an action unless it first weighs the probabilities and possibilities of recovery at a trial, Judge Brieant's determination places this function exclusively in the province of Justices who have no experience whatever in complicated Sec 10(b) law.

A reading of the report of the State Court referee reveals that the referee, recognizing that state law also required a weighing of the probabilities and possibilities of recovery at a trial against what is being proposed in settlement (*Rodgers v. Sound of Music Co.*, 74 Misc. 2d 699, 343 NYS 2d 672, 677-678; *Heimann v. American Express Co.*, 53 Misc. 2d 749, 767; *Matter of New York Title & Mortgage Co.*, 170 Misc 109; *Waterman Corp. v. Johnston*, 106 NYS 2d 813, affd 279 App Div 1073), devoted much of his report to a consideration of the probabilities and possibilities of recovery at a trial (A-180-185, 189-203). In his report, the Referee stated the issue as follows (A180):

> "There are obviously two parts to the question of the fairness of a proposed settlement of a pending case:
>
> 1. The chances of recovering a judgment against defendants from whom a substantial judgment is collectible; and
>
> 2. The amount of damages recoverable after trial in the case."

A further reading of the referee's report reveals that, as is to be expected, in weighing the probabilities and possibilities of

recovery, he considered the matter as if it were a common law matter rather than a Sec 10(b) matter. In confirming the referee's report, State Court Justice Markowitz adopted this approach. In affirming Justice Markowitz' determination without opinion, the State Appellate Division adopted this approach. The State Court of Appeals in denying appellants leave to appeal, left things in status quo.

In recent times, this court has decried the inability of attorneys duly qualified to handle State Court matters, to handle Federal Court matters. It has been pointed out that the ability adequately to handle State Court matters does not necessarily mean an ability adequately to handle Federal Court matters. We respectfully point out that the same reasoning must apply so far as the qualifications of judges is concerned. Congress has decreed that State Court justices are not qualified to determine Sec 10(b) claims. With all due respect to the State Court Justices who authorized the Supt to settle the Sec 10(b) case in the Federal court, they were unqualified by experience to determine the probabilities and possibilities of recovery of MCC's Sec 10(b) claim and did not do so. They chose, rather, to consider the Sec 10(b) claim as if it were a common law claim. We respectfully submit that justice, as well as the Sec 10(b) Federal exclusivity mandate of Congress, constrains the conclusion that the Federal court is required to determine the matter of the reasonableness of the settlement on the merits.

No Federal Judge has yet determined the probabilities and possibilities of Sec 10(b) recovery in the case at bar which is a prerequisite to determining the fairness of the settlement of the Sec 10(b) claim in the Federal Court. In fact, no judge, State or Federal, has determined the probabilities and possibilities of MCC's Sec 10(b) recovery. The State Court justices determined the probabilities and possibilities of common law recovery. Judge Brieant determined that, because the Supt is a state fiduciary appointed by the State Court to liquidate MCC, the matter of settling the Sec 10(b) case in the Federal court is an exclusively State interest which overrides the exclusively Federal Sec 10(b) interest so as to deprive the Federal court of any jurisdiction to determine the probabilities and possibilities of Sec 10(b) recovery and hence the fairness of the settlement on the merits. According to Judge Brieant's determination, this placed the Federal case in the posture where it could be settled by the Supt

without any court determination—State or Federal—as to the probabilities and possibilities of Sec 10(b) recovery. This was tantamount to arbitrary State Court approval of the settlement of the Federal Sec 10(b) case. It is neither common sense nor justice to permit this result in circumstances where the Federal action was the first action brought; where the State Court action was commenced two years after the Federal action; where nothing was done in the State Court from July 1965 when the action was brought, until August 1972 when the application for leave to settle was made by the Supt in the State Court; where there was substantial and vigorous activity in the Federal courts to establish the action as an exclusively Federal Sec. 10(b) action; where the Supt went as far as the United States Supreme Court to establish Federal exclusive Sec. 10(b) jurisdiction and the fact that the complaint stated a good cause of action under Sec 10(b).

Judge Brieant's determination is contrary not only to Congress' federal exclusivity mandate, and to justice and common sense, but as well, to relevant state and federal law.

Art XVI of the State Insurance Law, pursuant to which the Supt. was made liquidator of MCC, is intended to, and furnishes, a method of winding up the affairs of "insolvent" insurance companies under the aegis of the Superintendent of Insurance. Art XVI is intended to be a procedure for protecting the rights of creditors, policyholders, and stockholders of the company, as well as the general public. When an insurance company is, or may become, insolvent, the Supt. applies to the State Supreme Court for an order of liquidation (Insurance Law Sec. 513, 526). Under the order of liquidation, the Supt. is vested by operation of law with the title to all of the property, contracts, and rights of action of the company (Insurance Law Sec. 514). In his role of liquidator, the Supt. is a fiduciary of the Corporation, its creditors, policyholders and stockholders, and acts on their behalf.

As with all fiduciaries, the Supt. is not given uncontrolled discretion over the administration of the assets of the insolvent insurance company. His acts are subject to court direction, supervision and control.

Re: State Title & Mortgage Co., 160 Misc. 106,289 NYS 487 (Sup. NY, 1936)

In particular, Sec. 539 of the Insurance Law provides that the Superintendent may not, without court approval, settle or compromise doubtful or uncollectable claims. The specific language of the statute reads as follows:

> "The Superintendent may, *subject to the approval of the court*, (a) sell or otherwise dispose of the real and personal property, or any parts thereof, of an insurer against whom a proceeding has been brought under this article and (b) sell or compound all doubtful or uncollectible debts or claims owed by or owing to such insurer . . ." (Underscoring ours)

The question is: what is meant by the words "subject to the approval of the court", in the context of seeking court approval to settle a derivative cause of action predicated upon exclusively Federal law, where the action is pending in the Federal Court, and Congress has pre-empted *exclusive* jurisdiction for the Federal Courts.

It is clear that Sec. 539 was intended to follow the general pattern of situations where fiduciary actions are sought to be compromised and dismissed. Before this can be done, there must be court approval of the proposed settlement. The most universal example of this type of situation, is the derivative action.

Business Corporation Law, Sec. 626(d).
Rule 23.1 Federal Rules of Civil Procedure.

The action brought by the Supt. in the Federal Court is a derivative action brought on behalf of MCC for a Sec. 10(b) fraud which was perpetrated on the corporation. This cause of action is a valuable corporate asset. The Supt. is a fiduciary whose primary obligation is to insure that this valuable asset is not "given away" for less than it is worth. In order to insure that such a fiduciary will not violate his fiduciary trust, the statutes provide for court supervision of any attempt short of court determination, to dispose of such an asset.

Sec. 626 of the BCL, provides as follows:

> "(d) Such action shall not be discontinued, compromised, or settled, without the approval of the court *having jurisdiction of the action*". (Underscoring ours)

Rule 23.1 of the Federal Rules of Civil Procedure, which refers

to derivative actions provides as follows:

> "The action shall not be dismissed or compromised without the approval of *the court*, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs". (Underscoring ours)

In each instance, whether the statute refers to "the court having jurisdiction", as in BCL. Sec. 626, or simply to "the court" as in FRCP 23.1, they must be interpreted to mean the same thing. There may not be a compromise, settlement or dismissal of the action without the approval of the court having jurisdiction of the action. Interpretating Sec. 539 of the Insurance Law in the light of these statutes, the conclusion is inescapable that Sec. 539 likewise mandates that the words "subject to the approval of the court" contained therein, mean the approval of "the court having jurisdiction of the action".

This conclusion effectuates a reasonable balancing of interests between the state's interest predicated upon its appointment of the Supt. as liquidator of the affairs of MCC, and the Federal interest of mandated Sec 10(b) exclusivity. The State's interest is that there should be no interference by another court with the *general liquidation jurisdiction* of the State Supreme Court. That general liquidation jurisdiction is primarily to supervise the collection and distribution of assets.

Before there can be collection of an asset, however, there must be an asset to collect. In the case at bar, whether such an asset exists, and the amount thereof, has been placed in the exclusive power of the Federal court. After it determines this matter, the question of collection and distribution is for the State court, pursuant to its general liquidation powers. Each power is distinct from the other. The exercise of the Federal Court's power is a pre-condition to the existence of the State court's power.

In this order of powers, there is no interference by the Federal court with the general liquidation powers of the State Court. The jurisdiction of the State Court does not arise until the Federal court has first exercised the exclusive power granted it by Congress. By the same token, there should be no interference by the State Court, with the exclusive power of the Federal Court. The two separate and distinct powers—the exclusive Federal

power to determine the existence and extent of an asset, and the State power to collect and distribute that asset after it is determined to exist—are mutually exclusive, standing side by side to carry out the dictates of both Congress and the State Legislature.

The precise question has been posed by Professor Louis Loss in his treatise on Securities Regulation.

III Loss-Securities Regulation, 1961 ed., P 2007

In discussing the case of *Zachman v. Erwin*, 142 F. Supp. 745 (SD Tex, 1955), Professor Loss, on page 2007, note 13, pointed out that in circumstances where the plaintiff was suing a receiver and the State and Federal Courts had concurrent jurisdiction, the Federal Court referred the matter to the State Court and the State Court granted the plaintiff leave to proceed in the prosecution of the Federal action. Professor Loss then commented as follows:

> "It would be interesting to see what would happen in such a case with an action brought under the Exchange Act rather than the Securities Act; a ready solution would be for the state receivership court to authorize the plaintiff to litigate his claim in the federal court so as to avoid any question under the 'exclusive jurisdiction' language of the Exchange Act."

Common sense indicates that in the case at bar, the State Court should have declined jurisdiction to determine the fairness of the Sec 10(b) settlement as the province of the Federal Court. It should have sent the Supt to the Federal Court for authorization to settle the Sec 10(b) case. Since it did not do so, its determination is a nullity. Even under New York Law, the orders or judgments of a court which lacks subject matter jurisdiction, are a nullity.

Hughes v. Cuming, 165 NY 91 (1900)
Risley v. Phenix Bank of City of NY, 83 NY 318 (1881)

Further, because the State Court lacked subject matter jurisdiction of the Sec. 10(b) claim, any final decision of the state court would not have res judicata effect in the federal court.

Lewis v. Marine Midland Grace Trust Co., 1973 CCH Fed Sec Rep Par 94,206 P94,876 (SD NY 1973)

In *Lewis*, the court said at 1973 CCH Fed Sec Rep. Par. 94,206; Pg. 94,876. 94,885-886:

> "The plaintiffs' claims under Section 10(b) and Rule 10b-5 are cognizable only in the federal district courts. Securities Exchange Act of 1934 Section 27, 15 U.S.C. Section 78aa (1970). *Abramson v. Pennwood Investment Co.*, 392 F. 2d 759 762 (2d Cir. 1968) . . . Because the New York court lacks subject matter jurisdiction over plaintiffs' Section 10(b) and Rule 10b-5 claims, any final decision of that court would not have a *res judicata* effect here. *Wellington Computer Graphics, Inc. v. Modell, suppra.* 315 F. Supp. at 27."

Although a reasonable balancing of the State and Federal interests in the case at bar indicates a modus operandi which does not create conflict between the two, Judge Brieant concluded that there was a conflict between State and Federal Court exclusivity. By so concluding, Judge Brieant determined that the State interest overrode the Federal interest. As a matter of law, just the reverse is true. Federal jurisdiction cannot be restricted by State Law.

Payne v. Hook, 7 Wall 425, 19 L Ed 260 (1878)
Suydam v. Broadnax, 14 Pet 67, 10 L Ed 357 (1840)
Union Bank of Tenn v. Jolly's Adm's, 18 How 503, 14 L Ed 472 (1855)
Waterman v. Canal-Louisiana Bank & Tr Co., 215 US 33 (1909)

All of the above cases are directly in point.

In *Suydam*, the plaintiff brought an action on a note in the Federal court alleging diversity of citizenship. The action was brought against the administrator of the deceased debtor. The administrator sought a dismissal of the suit on the ground that the state statute pursuant to which the administrator was appointed, required actions against the administrator to be brought exclusively in the State Court. The Supreme Court of the United States held that despite the State statute, the Federal Court had jurisdiction over the action. A State statute could not oust a Federal court of jurisdiction and where a state statute

attempted to do so, the Federal jurisdiction must prevail.

The other cases cited above are substantially similar on their facts and hold the same way. A state statute cannot impair the jurisdiction of the Federal Courts over a case or controversy within the jurisdiction conferred by Congress.

We submit that in a situation such as the one at bar, where *exclusive* Federal jurisdiction is involved, the principle of Federal jurisdictional superiority must be applied with even stricter rigidity.

Miller v. Steinbach, 268 F. Supp. 255 (S.D., N.Y. 1967)

In *Miller*, the Court said at 268 F. Supp. 255, 268:

> "In other words, where an action is based on the federal securities laws, state substantive or procedural laws may not impede the application of the federal statute. Fleischer, 'Federal Corporation Law': An assessment, 78 Harv L Rev 1146, 1168 (1965)"

In his decision, Judge Brieant characterized appellants' argument that the determination of the State Court could not have any effect in the Federal court because the State Court lacked jurisdiction of the sec 10(b) claim, as "a non sequitur of the worst sort." (A21) His reasoning appears to be that "while the state court cannot adjudicate a Sec 10(b) claim, it can adjudicate the reasonableness and propriety of the exercise of his discretion by the State's fiduciary in settling such a claim." (A21). Judge Brieant's reasoning is that "the relief he (the Supt) sought from the state courts was the authority to settle," (A22) and that because all he sought was the authority to settle, "the state courts did not thereby adjudicate the Sec 10(b) claim, they adjudicated rather, the question of whether the Superintendent was acting fairly and reasonably in the exercise of his discretion in concluding to accept a settlement proferred to him by such of the alleged wrongdoers in this case who remain solvent." (A22)

The basic error of Judge Brieant lies in his failure to recognize that the State Court could not determine whether the Supt was acting fairly and reasonably in accepting the settlement unless it first considered the probabilities and possibilities of victory at a trial, which by congressional fiat it had no power to do, and weighed them against what was being proferred in settlement. Unless it did this, there was no way that the State Court could

determine whether the Supt was acting fairly and reasonably. This is the requirement of the Federal cases and the State Court cases. It was the approach not only of the State Court Referee, but as well, of State Court Justice Markowitz in confirming the Referee's report.

We submit that in this basic respect, Judge Brieant's determination was predicated upon a misapprehension of the function of the court in determining whether court approval of the Supt's settlement was justified.

From the outset of his assertion of MCC's claim against the defendants, the Federal Court rather than the State Court was the court to which appeal was made by the Supt. The Federal action was the first action brought. The activity in the Federal court was substantial and vigorous for approximately nine years. Until the application for leave to settle was made in the State Court, nothing was done in that court except to start a common law action two years after the commencement of the Federal action. In the circumstances, Judge Brieant's determination violated the fundamental duty of the Federal court to take jurisdiction over the case at bar instead of turning it over to the State Court. As stated in *Lewis v. Marine Midland Grace Trust Co.*, 1973 CCH Fed Sec L Rep Par 94,206; P 94,876,885,886:

> "[W]hen a federal court is properly appealed to in a case over which it has by law jurisdiction, it is its duty to take such jurisdiction. [Citations omitted] It has also been considered to be the rule that when a federal court is presented with a case of which it has cognizance it may not turn the matter over for adjudication to the state court, and that the pendency of an action in the state court is no bar to the proceedings concerning the same matter in the federal court . . ."

POINT II

THE STATE COURT, THE REFEREE, AND THE SUPT DEPRIVED MCC, ITS CREDITORS, THE SOLE STOCKHOLDER OF MCC, AND THE TAXPAYERS OF THE STATE OF NEW YORK, OF CONSTITUTIONAL DUE PROCESS AND EQUAL PROTECTION OF THE LAWS.

In agreeing to settle the case for $1,000,000 the Supt. was not basically motivated by a weighing of the probabilities and possibilities of victory at a trial against the $1,000,000. He appears to have been motivated by the predicate that $1,000,000 would be sufficient to pay all of MCC's creditors and that if he could convince the court of this, he did not have to go any further and show the real potential of recovery by MCC in contrast to the amount being received in settlement. Inherent in this approach is the predicate (1) that if $1,000,000 were not sufficient to pay the claims of all creditors, the Supt would not have agreed to the settlement, and (2) that the rights of appellant Estate of Brandenburg, the sole stockholder of MCC, could be disregarded.

Even though the state court purported to accept as controlling, the proposition that it was legally required to reach a conclusion based upon the balancing of the probabilities and possibilities of recovery at a trial against the $1,000,000 offered in settlement, in the last analysis it put aside consideration of this matter and premised its authorization on the postulate: (1) that $1,000,000 was sufficient for the payment of the claims of all of MCC's creditors, and (2) that any rights of appellant, Estate of Brandenburg could be disregarded.

The state court was able to reach this conclusion only by violating the due process equal protection rights of MCC, its creditors, the sole stockholder of MCC and the taxpayers of the state of New York.

A. *The State Court Afforded A Hearing In Name Only*

All of the factual information necessary to show the number of MCC creditors, the amount of their claims, and the amounts which would be necessary to pay the creditors of MCC, were within the peculiar knowledge of the Supt. The Last Report by

the Supt to the State Court concerning the assets and liabilities of MCC had been made in 1967. Since that time no information had been given out to any Court or otherwise concerning the financial status of MCC. (A-204)

In connection with the anticipated hearing before the Referee, the Supt. advised the Referee that he would present testimony whose purpose was to show that if the actions were settled for one million dollars, MCC would have sufficient assets to pay the claims of all MCC creditors and all of its other obligations. The attorney for the appellants thereupon wrote a letter to the Referee requesting, among other things, that he be furnished in advance, with copies of the papers which would be used by the Supt. as the basis for the testimony that the one million dollar settlement would be sufficient to pay the claims of all creditors, and that he be granted the right to examine the Supt's. witnesses on a pre-hearing basis, at least one week prior to the hearing (A53). The request was denied (A-56).

Thus the appellants were deprived of an effective tool for cross-examination in cricumstances where the information was peculiarly within the knowledge of the Supt.

At the Hearing, the evidence submitted by the Supt. to support his argument that one million dollars would be sufficient to satisfy all the claims of creditors, consisted of two exhibits: (a) a paper entitled "Statement of Additional Funds Required to Pay All Claims as at Dec. 31, 1972", which was made in 1972, about one year prior to the hearing before the Referee (A57, 58) and (b) a paper entitled "Summary of Inventory of Claims Reviewed, Evaluated and Reserved" dated February-March 1973 (A59). Over objection of counsel for the appellants, the Referee admitted into evidence, the testimony of two witnesses whose testimony was nothing more than a repetition of the contents of these papers, and who had nothing to do with their making.

The attorney for the appellants objected to the admission into evidence of the above papers on the ground that they were hearsay and did not come within the business records exception (A60, 66). The objections were overruled even though the testimony showed that the papers were not made in the regular course of the business (A80-81, 122).

The Statement of Additional Funds Requires to Pay All Claims as at Dec. 31, 1972 (A57-58).

Minches was the only witness called by the Supt. to testify concerning the paper entitled "Statement of Additional Funds Required to Pay All Claims As At Dec. 31, 1972." Over the objection of appellants' counsel, Minches was permitted to testify concerning its hearsay contents. He had no other papers to support his testimony, admitted that he did not see the document being prepared, (A120), and that he did not know what was done in the preparation of the paper (A122). Minches further testified that he assumed it was prepared by Herbert Cohen, the controller of the Liquidation Bureau (A120-121), but Cohen was not produced to testify.

The unreliability of the paper as well as of the Minches testimony, was clearly shown.

On page 2 of the "Statement", is an item for "suspended claims" in the amount of $528,207.13. Minches testified that it was the reserve which had been set up for suspended claims, but that he did not know the total of these claims (A126).

On page 2 of the "Statement" is an item "additional reserve on claims in suit not reserved", in the amount of $300,000. Minches had no idea as to the total amount of these claims (A-127).

On page 2 of the "Statement" is an item "reserve for disallowed claims before referees" in the amount of $234,040. Minches had no idea as to the total amount of these claims (A127).

On page 1 of the "Statement", is an item "estimated future expenses" in the amount of $275,000 and "estimated future administrative expenses" in the amount of $450,000. When it became evident from the testimony of Minches that he could not explain the manner of computation of these items (A-128-131), the Referee made his own objection to cross examination on the subject of the future expenses and refused to permit further inquiry, on the ground that "they are still uncertain" (A131). So unknowledgeable was Minches on the subjects as to which the Supt. offered his testimony, that he did not even know how much the attorneys in the litigation were paid (A146); whether their disbursements were paid (A146); or the amount of their fees (A146).

On page 1 of the "Statement", under the item "general claims, deferred", is an item of $400,000. Minches testified that this was a reserve, but that he had no idea concerning the totel amount of these claims (A134-135).

At A138 to A141, the attorney for the appellants' endeavored to ask questions concerning the number and amount of the claims filed as of November 8, 1967 the date of the seventh and last Comprehensive Report; the number and amount of the claims thereafter filed; and the number and amount of claims allowed and disallowed during this period. The purpose was to show what disposition was made of the $301,200,000 timely stated claims which, according to the Seventh Comprehensive Report, had been filed as of November 8, 1967; and of the 6441 timely unstated claims, plus the $10,901,323.41 late stated claims, and the 662 late unstated claims which had been filed as of that date; that the portion thereof which remains undetermined is so substantially great, as to show that the reserves presently allowed are wholly unrealistic; that the Supt's. track record as to claims initially disallowed by him but subsequently determined to be valid by the courts, and the reserves allowed by him to cover necessary contingencies is so unrealistic, that a one million dollar settlement would be clearly insufficient to pay all claims of creditors. The Referee refused to permit the questions to be answered, and directed the appellants' attorney to "go on to something else" (A-140). The Referee agreed that appellants' attorney would have been deemed to have been made an offer of proof (A141).

According to the "Statement" (A57), a total of $768,294 additional would have been required as of December 31, 1972, to pay all the claims of creditors. Minches was permitted to testify concerning this statement even though it was inadmissable hearsay and he had no personal knowledge concerning it (A120, 122, 131, 132). He was also permitted to testify that in arriving at the $768,294 figure, there was included in liabilities, a reserve of $1,500,000 for open claims (A108). Yet he was not able to say how the reserve figures were arrived at.

The Summary of Inventory of Claims Reviewed, Evaluated and Reserved (A59)

The amount of funds required to pay the claims of creditors is

directly related to the "reserves" set up by the Supt. In February-March 1973, in preparation for the hearing before the Referee, the Supt. went about preparing the "Summary" expressly for the hearing before the Referee which was to take place shortly thereafter (A80, 131). The object was to reduce $312,101,324.41 claims as of November 8, 1967 the date of the last (seventh) report, to a reserve of $1,500,000 (A108).

Peterman, an employee of the Supt. who, for the past two years had been employed to review, evaluate and write up claims and suits pending against insolvent insurance carriers (A62), testified concerning the making of "the summary" (A59). He testified that in February 1973 he was requested by Dowling, his boss (A80-81) to make a review of the open and outstanding claims involving Manhattan (A63). He was to do this with three other employees, who assisted him (A63). The review was to be made for the purpose of the hearing at which the Superintendent was endeavoring to show that the one million dollar settlement would be sufficient to pay the claims of all creditors (A80). Dowling, Peterman's boss, had a special interest in wanting the settlement approved. He was the Special Deputy in charge of approving the settlement on behalf of the Supt.

Prior to the time that Peterman had been requested to make the review, the "Statement of additional funds required to pay all claims as at December 31, 1972" had been prepared (A109). This was the previously made paper whose figures were to be confirmed by Peterson's review. According to that "Statement," the additional funds required would be covered by a $1,000,000 settlement. The additional funds "required," were largely dependent upon the amount of reserves allowed for pending claims. Peterman was called upon by his boss to "fix" the figure for these reserves. The conclusion is inescapable that his job was to see to it that the reserves "set up" by the team coincided with and confirmed the "Statement."

None of the members of the estimating team was either an attorney or an accountant (A-75, 78). Where they thought legal questions were involved, they submitted legal memoranda to Hannon, trial counsel for the Supt, in which *they* set forth the issues (A78-79). Hannon would pencil in an answer (A77). Of the hundreds of claims which they reviewed, they saw fit to write only 12 requests for legal opinions (A77).

They considered 50 to 100 files per day (A65). On the basis of a 7 hour day, this meant they spent 8 minutes per file if they considered 50 files, and 4 minutes per file if they considered 100.

No particular formula was used for fixing the reserves (A81, 92). *The reserve was fixed on the basis of what Peterman in his own mind, determined should be fixed* (A81). The referee Sua Sponte suggested that in considering the claims, Peterman took into consideration "a lot of imponderables" (A92), and further suggested that this was a formula (A92). Among the imponderables was: who the attorney for the claimant was and the court in which the action was brought (A93). Yet Peterman did not know how many of the "to be adjudicated" matters were before the courts (A87-89).

When Peterman admitted that he had prepared for himself working papers to support the so called "Summary" from which he was testifying, appellants' attorney requested that the working papers be produced for cross examination purposes (A78-79). The application was denied by the referee (A79).

The paper and testimony of Peterman were tainted by the violation of two fundamental principles enunciated by the State Court of Appeals.

> *Stewart v. Citizens Casualty Co.*, 23 N.Y. 2d 407, 297 NYS 2d 115 (1968)

First, the setting up of reserves must be arrived at by actuarial calculations and not by the slipshod-no-formula-method used by the Supt. As stated in *Stewart*, at 297 NY Supp 2d 115, 121:

> ". . . It is clear that the question of sufficiency of reserves is not solely a question of statutory interpretation, but rather a factual determination to be arrived at *by actuarial calculations.*" (underscoring ours)

Second, it was error for the Referee to deny objectants' attorney the right to inspect the backups for the "Statement of Additional Funds" (A57-58), and the "Summary of Claims Reviewed" (A59). As stated in *Stewart* at 297 NY Supp 2d 115, 121:

> "This would appear reasonable in light of the fact that the Legislature, when dealing with administrative proceedings, specifically delineated the rights of a party

> in such a hearing. 'Every person affected shall be allowed to be present during the giving of all the testimony, and shall be allowed a reasonable opportunity *to inspect all adverse documentary proof*, to examine and cross examine witnesses, and to present proof in support of his interest' (Section 23)." (Underscoring ours).

Not only was unreliable testimony flagrantly permitted concerning the above mentioned unreliable documents, but as well, the Referee refused to permit cross examination to show that there was a compounding of unreliability on unreliability.

Among the claims on the "Summary" were 588 "suspended personal injury and property damage claims". Peterman had allowed a reserve of $148,088.00 as to these. In order to test the reasonableness of this reserve, the attorney for the appellants asked Peterman for the total money amount of the claims (A-83). The Referee sustained the objection to this question (A83).

Among the claims on the "Summary" were 143 "suspended general liability claims". Peterman had allowed a reserve of $191,700.00 as to these. In order to test the reasonableness of this reserve, the attorney for the appellants asked Peterman for the total money amount of the claims (A84). The Referee sustained the objection to this question (A84).

Under item 5 of the "Summary", are "claims not stated". These were claims concerning which the claimant had not specified a money amount. Peterman testified that in making his evaluation, he did not liquidate the claims (A84). When asked how he made his evaluation of these claims, he answered that he couldn't say without the files (A84-85). The attorney for the appellants requested the production of the files stating that "I can't cross examine this witness without having the necessary papers here, and they have not produced the necessary papers." (A-85). The Referee denied the application (A85).

Peterman was asked how he evaluated the 26 general liability claims of the "claims not stated" (A86). He answered that he would have to answer on a per-case basis, and would need the file whose production the Referee had previously refused to direct (A86). The Referee nevertheless adhered to his previous ruling.

On the "claims to be disallowed", some 939 claims, Peterman testified that not one penny of reserve was allowed (A86-87). Thus, in calculating the reserves to be set up, it was assumed that the unformularized determintions made by Peterman and his team were absolutely correct. This attitude prevailed even though they did not know how many cases were before the courts (A87-88).

Under item 3 of the "Summary" are some 1171 claims "to be adjudicated". Among these claims are 755 stated claims (column 4), and 433 "claims not stated" (column 5). The amount of reserves allowed for each of the claims classified under the heading "classification" was set forth in column 6. No breakdown was given for the reserves allowed in connection with the "stated claims" and the reserves allowed in connection with the "claims not stated". All that the "Summary" gives, is a breakdown of the reserves allowed for each classification, with a total of reserves allowed for all classifications in the amount of $943,986.91. In order to test the reasonableness and reliability of each category of reserve and the ultimate total, the attorney for the appellants asked Peterman for the total money amount claimed by the claimants (A88). The Referee sustained the objection to this inquiry.

Peterman was asked whether, prior to making the "Summary", he had consulted the last and Seventh Comprehensive Report of the Superintendent (A90); whether he had sought to ascertain the total amount of claims made in that report (A90); and whether he had consulted it for the purpose of ascertaining what part of the claims had been disallowed and what part of the disallowed claims had ultimately been adjudicated as good claims by the courts (A90). His answer was a negative. He conceded that in making the "Summary", he had consulted nothing but the files (A-91).

Thus, Peterman did not even ascertain whether he had passed upon all the outstanding claims. All he could testify to was that he had passed upon the files which were given to him. In order to ascertain whether he had passed upon all the outstanding claims, he would have had to consult the claims contained in the Seventh Comprehensive Report of the Supt., which was the last report filed by the Superintendent (A137); would have had to ascertain which of those had been passed upon and which had

not been passed upon since November 8, 1967, the date of that report; and would have had to ascertain whether the files which he passed upon were those which remained after eliminating from the claims remaining open according to the Seventh Comprehensive Report, the claims which had been passed upon up to the time when Peterman made his computations. This was concededly not done.

Although Peterman set up the reserves with three other employees who allegedly assisted him (A63), each one of them set up his own reserves (A102). Neither one of them consulted the other as to the reserves set up by him and did not know the reserves set up by the others. Hence, when Peterman was questioned concerning the reserve which had been set up for the claim of appellant Berg, he testified that he had never heard of Berg and did not know the amount of the reserve which had been set up (A102).

In permitting testimony as to the "Summary" without requiring the production of the back up papers and documents, not only did the Referee permit Peterman to testify as to a hearsay document which gave Peterman immunity from cross examination, but as well, the Referee permitted him to testify concerning parts of the "Summary" which were made by his other two assistants and concerning matters as to which he had no information of any kind. At no time did the Referee require the Supt., in offering Peterman's testimony, to show which part of the hearsay paper was Peterman's and which part was attributable to his assistants. The paper was hearsay, on hearsay, on hearsay. The testimony was hearsay, on hearsay, on hearsay. The rulings of the Referee were calculated to prevent questions designed to attack the competence and credibility of the "evidence" offered.

The order of State Court Justice Markowitz appointing the Referee to hear and report on the fairness of the settlement was predicated upon Justice Markowitz's conclusion that the moving papers of the Supt. pursuant to which the proceeding for court approval of the settlement were commenced, contained "insufficient evidence on which to find the proposed settlement adequate . . ." (A169). To all intents and purposes the "hearing" did not add any competent evidence to this original lack of sufficient evidence. The referee's evidentiary rulings were

not merely erroneous. They were flagrantly violative of every rule developed for the purpose of insuring the search for truth through adversary proceedings.

The referee curtailed and prohibited any meaningful cross examination. He permitted the Supt. to introduce into evidence any matter desired by the Supt regardless of the fact that its competence was patently unreliable. He disregarded every traditional standard of evidentiary competence and reliability. When the Supt's witnesses found themselves in troubled waters, the Referee intervened to explain away their difficulties. The "hearing" became a forum permitting the Supt to introduce anything he pleased, regardless of its reliability, so long as it justified the Supt's claim that $1,000,000 would be sufficient to pay the claims of all of MCC's creditors. In short, the referee held not an adversary hearing, but rather an ex parte hearing at which appellants' attorney was permitted to ask questions as long as they did not require an answer which might be hurtful to the cause of the Supt. When that possibility arose, the Referee either made his own objection on behalf of the Supt or sustained the objection of the Supt. So far as appellants were concerned there was a hearing in form but not in substance.

We submit that the hearing was flagrantly inconsistent with every fundamental principle of justice and fairness, which infringed upon the traditional and constitutionally secured right to a fair trial and adversary hearing.

B—The State Court Disregarded The Plain Meaning Of Evidence Presented By The Supt Which Clearly Reveals That The $1,000,000 Settlement Will Not Provide Enough Assets For MCC To Pay Its Creditors.

1. In order to show the additional funds required to pay all the claims of creditors, the Supt. submitted the "Statement of Assets and Liabilities of MCC *as at December 31, 1972* (A57-58). According to that statement, on the basis of the assets and liabilities of MCC as at Dec. 31, 1972, the total additional funds required to pay all proper creditors would be $765,294.

One of the items in the asset part of the statement, is "Securities (*Market Value December 31, 1972*)," in the amount of $2,620,000. Minches, the witness called by the Supt to testify

concerning the above statement, *had no information concerning what these securities were and did not have a list thereof* (A122); had never consulted a list of the securities (A122); *and did not know either the value of the securities as of March 31, 1973 or the cost basis of the securities* (A122). Nor did he know whether consideration had been given to whether commissions would have to be paid when the securities were sold (A122-123), or to whether a tax would have to be paid when they were sold (A123). The referee sustained an objection to the question whether consideration was given to what value the securities would have when the monies are distributed to the creditors (A124), which Minches indicated would probably be in no less than two years (A123-124).

Considering what has happened in the securities markets since December 1972, the information requested was vitally important. Without it, any conclusions predicated upon the value of the aforementioned securities were worthless.

The court can take judicial notice that December 31, 1972 was the highest market valuation for securities in the past twelve years and since that time the value of securities has declined substantially (See Ex. 1 annexed hereto—Dow Jones Industrials from New York Times 12/8/74 Sec. 3, p. 6). As evidenced by recent news headlines (New York Times 9/22/74 page 1; Wall Street Journal, 10/1/74 page 1), virtually all major foundations, including the giant Ford Foundation, have suffered from a substantial decline in the value of their securities since December 1972.

Annexed to this brief as Exhibit 2, is the New York Stock Exchange's Composite Index for the week ended Dec. 6, 1974. This appeared in the New York Times of Dec. 8, 1974, Sec. 3 page 6. A similar composite appears in the financial section of the New York Times every Sunday.

According to this composite, December 31, 1972 was the highest stocks have been since that time. Between Dec. 31, 1972 and Dec. 6, 1974, the composite fell from 65½ to 34½, a decline of 48%. On that basis, the securities which were valued by the Supt. in (A57) at $2,620,000 must have declined by 48 percent or $1,257,600. This leaves the December 31, 1972 statement short by no less than an additional $1,257,600 for the payment of the claims of proper creditors.

This was the situation when we wrote our brief below. Since then, the securities market has made an upturn. In order to show the effect of this upturn, we annex to this brief as Ex 3, the New York Stock Exchange's Composite Index for the week ended August 8, 1975 which appeared in the New York Times of August 10, 1975 Sec 3, P 4. This composite shows that due to the recent upturn in the securities market, the composite is back to 46. Thus, as of August 8, 1975 the composite fall is from 65½ on December 31, 1972 to 46, a decline of 30 percent. On this basis, the securities which were valued by the Supt in (A57) at $2,620,000 must have declined by 30 percent or $786,000. This would leave the December 31, 1972 statement short by no less than an additional $786,000 for the payment of the claims of creditors.

2. At (A212-214) of his Report, the Referee found that on the basis of the claims against MCC which had already been processed and allowed as of December 31, 1972, MCC was clearly obligated to pay $5,020,666.85. This is a summary of the figures contained on page 2 of the December 31, 1972 Statement (A58). None of these monies have been paid to date (A216).

These claims must be paid *with interest from the date of the accrual of the claim* (A157). This would be a fixed interest liability of no less than 6 percent per year.

Disregarding for the moment the fact that interest on these claims accrued prior to December 31, 1972 when they were allowed, as well as the fact that it will take two more years even if the case were settled at the present time, before the creditors are paid (A123-124), and giving consideration only to the figures commencing December 31, 1972 when the claims were allowed, it is clear that no less than 16 percent interest has already accrued thereon. This would amount to an additional payment of no less than $803,306.70. If we give further consideration to the fact that even if the case were settled at the present time it would take two more years before these claims are paid (A123-124), another 12 percent minimum interest would have to be paid, making an additional $602,479.90. Thus, the total minimal interest on these *allowed claims* would be no less than $1,405,786.60.

Yet in determining that $1,000,000 was sufficient to pay all

the claims of creditors, the State Court disregarded the plain fact that no provision was made for the payment of this substantial interest obligation of no less than $1,405,786.60. (A57, 58, 59)

3. According to Minches, the $768,294 "Total additional funds required" according to (A57-58) to pay all the claims of creditors as at December 31, 1972, was predicated upon the inclusion in liabilities of a reserve of $1,500,000 for open claims (A108). When these claims are allowed, interest from the date of accrual would have to be paid thereon (A157).

If, for present purposes, we accept this reserve figure as correct, and disregard the fact that interest must be paid thereon from the date of their accrual, it is clear that since those claims accrued prior to December 31, 1972, no less than 16 percent interest or $240,000 would be due thereon from December 31, 1972 to the present time, and an additional 12 percent or $180.000 would be due if we consider that it would take another two years before the money is paid (without consideration to how much longer it will take to process these claims) even if the case were settled at the present time.

Yet in determining that $1,000,000 was sufficient to pay all the claims of creditors, the State Court disregarded the plain fact that no provision was made for the payment of this substantial interest obligation of no less than $420,000.

4. Secs. 330 and 333 of the Insurance Law, Sec. 17 of the Vehicle and Traffic Law and Art. 6 (a) of the Workmen's Compensation Law, provide for the creation of funds out of taxpayers' monies which may be used to make advances of payments with regard to insurance companies in liquidation (A205-206). The Commissioner of Taxation and Finance is the custodian of the funds and he is authorized to make payments from the funds upon certificates filed by the Supt. acting as liquidator (A206). In accordance with these laws, various monies were advanced by the Commissioner of Taxation in connection with MCC claims (A206). This gave the Commissioner a claim for the repayment of said amounts (A206).

As shown in (A57), provision was made in the Dec. 31, 1972 Statement of additional funds required to pay creditors' claims, for reimbursement for the payments made. ***However, no provision was made for the payment of administrative expenses to the Commissioner*** *[A142], or the Motor Vehicle Liability*

Security Fund [A142-143]. *or the Workmen's Compensation Security Fund* [*A143*]. Instead, the Supt, in his application for leave to settle the case, asked the State Court to determine that the Commissioner, as custodian of the above funds, either has no claim for administrative expenses regarding the above payments, or has a claim which is subordinate to the claims of general creditors. The State Court determined, *without any appearance by the Commissioner*, that the Commissioner does not have a claim as a general creditor for administrative expenses, but that if surplus assets exist after the payment in full of all creditors with interest, the Commissioner may make a claim to the surplus funds for said administrative expenses (A156-157). To the extent that no provision was made for the payment of the administrative expenses of the Commissioner, *the settlement is at the expense of the taxpayers of the State of New York.* On the basis of the Supt's $2,225,673 administrative expenses, the administrative expenses of the Commissioner could be $250,000.

To the extent that the State Court participated in this give away of taxpayer money, the due process rights of the taxpayers of New York were violated.

Thus, *on the basis of the evidence presented by the Supt.* if the case is settled for $1,000,000, there would be a minimal deficiency for the payment of the claims of all creditors of no less than $1,093,492 calculated as follows:

Decline in value of Securities (Par 1 above)	$ 786,000
Minimal interest on allowed claims (Par 2 above)	1,405,786
Minimal interest on claims allowed in the future (Par 3 above)	420,000
Comm. of Taxation and Finance Admin. Expenses (Par 4 above)	250,000
Total Deficiency	2,861,786
Deduct Dec. 31, 1972 deficiency as claimed by the Supt. of Insurance on (A57-58)	768,294
Minimal deficiency on the basis of the Supt's evidence	2,093,492

Less $1,000,000 settlement	1,000,000
Minimal deficiency if case settled for $1,000,000	1,093,492

From the foregoing, the State Court, the Referee, and the Supt violated the due process and equal protection rights of MCC, its creditors, its sole stockholder, and the taxpayers of the state of New York in the following respects:

1. The State Court afforded a hearing in name only, which infringed upon the traditional and constitutionally secured right to a fair trial and adversary hearing.

2. The State Court disregarded the plain meaning of evidence presented by the Supt which revealed that $1,000,000 would not be sufficient to pay the claims of all the creditors of MCC, including the Commissioner of Taxation by no less than $1,093,492 thereby taking the property of the creditors without due process to the extent that there would be insufficient funds to pay their claims.

What was done in the state court did not amount to mere judicial error. Taking the individual parts and the sum of all the parts, what was done in the State Court deprived the appellants of a fair opportunity to be heard, of a right to a fair and open hearing, and was wholly inconsistent with fundamental principles of justice. It rose to the level of arbitrary and wanton interference with appellants' right to protect the property of MCC, their interest therein, and the interest of the creditors and sole stockholder of MCC. It amounts to a spoliation of appellants property and the property of those whom they sought to represent. It amounted to treating appellants differently and unequally from other litigants. We submit that the infringements on the rights involved rose to constitutional dimensions.

Douglas v. City of Jeanette, 130 F 2d 652 (CA 3, 1942)

POINT III

THE STATE COURT VIOLATED THE DUE PROCESS RIGHTS OF MCC AND THE SOLE STOCKHOLDER OF MCC

The State Court referee found that the following could be proved at a trial: On January 24, 1962, Irving Trust issued its $5,000,000 check payable to Bankers Life (A192). At the time, neither MCC nor any of the persons or entities with whom Irving Trust was dealing, had any account at Irving Trust (A195). The check was delivered to Bankers Life by Gunter, the Assistant Secretary of Irving Trust who issued the check and who had authority to sign Irving Trust checks in any amounts without clearing it with any of the bank's other officers. The check was used to pay Bankers Life for the sale of its 100 percent stock interest in MCC (A190), to Begole (A191-192). Immediately after the sale by Bankers Life of MCC's outstanding stock to Begole, the old directors of MCC resigned and new Begole directors were elected (A192-193). The Begole directors held a special meeting at which they adopted a resolution to sell MCC's entire portfolio of Treasury Bonds (A192-193). The bonds were delivered to Irving Trust for sale, and *sold by Irving Trust to Irving Trust's subsidiary securities company* for $4,854,553.67 (A195). This amount, together with an MCC check for $150,000 was *credited to Irving Trust's internal checks clearing account* to cover the $5,000,000 check which Irving Trust had issued and made payable to Bankers Life (A195-196).

In 1963, Matthew Brandenburg was a practicing attorney who represented Begole. Brandenburg had not represented Begole when the shares were purchased from Bankers Life. On May 17, 1963, for legal services, Begole transferred all his MCC shares to Brandenburg who thereby became the sole stockholder of MCC. Brandenburg has since died and his Estate has become the sole stockholder of MCC in his place.

In reaching the conclusion that the measure of recoverable damages against the financially responsible defendants would be limited to an amount which is sufficient to pay the creditors of MCC their claims in full, the referee and State Court reasoned that since Brandenburg obtained his shares from Begole, a

defrauder, his stock interest is not to be given any consideration and hence the "damages recoverable at a trial would be the amount needed, in addition to whatever other assets Manhattan had, to pay all proper claimants of Manhattan, as well as the expenses of the lawsuit and of the liquidation proceeding." (A160-161, 184, 203)

This is a novel proposition of law which contradicts the well established rule that wrongs done to a corporation give rise to a claim for damages by and on behalf of the corporation. Such wrongs do not give rise to an individual claim for relief by the stockholders or creditors of the corporation.

> *Koster v. Lumberman's Mutual*, 330 US 518, 522 (1947)
> *Hawes v. Oakland*, 104 U.S. 450, 460 (1881)
> *Kauffman v. The Dreyfuss Fund Inc.*, 434 F 2d 727 (3 Cir. 1970)
> *Ash v. International Business Machines, Inc.*, 353 F2d 491, 493-494 (3 Cir. 1965) cert. den. 384 US 927
> *Keenan v. Eshelman*, 23 Del Ch 234, 2 A 2d 904
> *Smith v. Hurd*, 53 Mass. 371 (1847)

The State Court's reasoning improperly converted a corporate wrong into a representative claim for relief by the creditors of the corporation, instead of treating the corporate wrong as a claim for corporate relief as required by law. The difference between direct wrongs to corporate stockholders and creditors (representative actions), as distinguished from direct wrongs to the corporation, has long been recognized by all courts. They are not interchangeable.

> *Gordon v. Elliman*, 1952, 202 Misc. 612, 115 N.Y.S. 2d 567; Affd. 280 App. Div. 655, 116 N.Y.S. 2d. 671; Afd. 306 N.Y. 456.

What the State Court and referee did was specifically proscribed by the Supreme Court of the United States in *Supt. of Ins. v. Bankers Life* at 404 US 6, 12 where the court said:

> "And the fact that creditors of the defrauded corporation buyer or seller of securities may be the ultimate victims does not warrant disregard of the corporate entity."

Apart from disregarding MCC's corporate entity and its actual Sec. 10(b) damages in violation of established principles

of law, in order to limit the amount of damages recoverable by MCC, the court below treated Brandenburg as a defrauder when he was not.

On January 24, 1962 when Bankers Life received the Irving Trust $5,000,000 check, it intended to transfer its 100 percent stock interest to Begole. *The Sec. 10(b) fraud against MCC took place not when this check was given to Bankers Life, but rather afterwards, when Irving Trust sold and converted the proceeds of the sale of MCC's Treasury Bonds to itself.* In the circumstances, Begole obtained a good title to the MCC shares which, as a matter of law, he could transfer to a third party.

UCC Sec. 2-403

UCC Sec 2-403 (1) provides that "a purchaser of goods acquires all title which his transferor had or had the power to transfer . . . " It further provides that a "person with voidable title has power to transfer a good title to a good faith purchaser for value."

The title of Bankers Life to all the stock of MCC, was stock ownership of 100 percent of the shares of MCC. This title was transferred to Begole on Jan. 24, 1962 when Bankers Life, in payment for the stock, received the $5,000,000 Irving Trust check. In 1963, for valuable consideration, the shares were transferred by Begole to Brandenburg, Begole's lawyer. Since Begole received a good title to the shares from Bankers Life, he had the right to, and did, transfer his good title to Brandenburg. Even if Begole had a voidable title, Brandenburg acquired a good title thereto. Brandenburg was a good faith purchaser for value within the meaning of UCC, Sec. 1-201 (19).

Thus, Brandenburg acquired all the rights of a 100 percent stockholder of MCC. Among these rights is the right, upon liquidation of MCC, to receive whatever corporate assets remain after the payment of liabilities. The State Court determination, that Brandenburg's stock interest is to be given no consideration in determining whether the settlement is fair and reasonable, has the effect of arbitrarily taking this right from Brandenburg's estate and denying MCC the right to recover, at a trial, the full amount of damages actually sustained by it, in accordance with well settled principles of law. Further, the State Court deter-

mination in effect voided the sale from Bankers Life to Begole even though Bankers Life was the only one who had standing to bring such an action, and no such action was brought by Bankers Life. In fact, both the referee and the State Court, by finding that "the case itself as against Bankers Life on the basis of fraud or conversion is, according to all the records, entirely unsupported," (A14).

The summary determination of the State Court without a trial, treated Begole as if there was a fraud connected with the initial sale of stock by Bankers Life to Begole, and Brandenburg as if he were a defrauder. This was in patent disregard of the law, especially Sec 2-403 of the UCC. It was in patent disregard of the specific findings of the referee. It was in patent disregard of the fact that the Supreme Court of the United States in *Supt of Ins. v. Bankers Life* 404 US6, did not resolve the issue of whether there was fraud connected with the initial sale of stock to Begole. In *Karvelas v. Sellas,* Current CCH Fed Sec Law Rep Par 94, 801; P 96,662; 96,664 (DC, NC Ill, 1974), the court after giving a history of *Supt of Ins. v. Bankers Life* in the federal courts with the holding of each court, concluded as follows at page 96,665:

> "Consequently, the court (US Supreme Court) did not resolve the issue of whether there was fraud connected with the initial sale of stock to Begole."

The summary determination of the State Court was in patent disregard of the factual likelihood, stated by the courts, that at a trial, a fraud in connection with the sale of the shares from Bankers Life to Begole would not be found. It was in patent disregard of the fact that no possibility existed whereby Brandenburg could be found to be a defrauder at a trial.

In these circumstances, for the State Court to have made a summary determination which deprives the Estate of Brandenburg of its property rights as the sole stockholder of MCC, constitutes a deprivation of property without due process. For the state court to have concluded that, because it does not have to give consideration to the Brandenburg Estate as sole stockholder of MCC, it can limit the damages to which MCC would otherwise have been entitled, constitutes a taking of MCC's property without due process, and a give-away of MCC's property to the wrongdoing defendants.

What the state court did cries out for intervention by the Federal Court.

As stated in *Societe Internationale v. Rogers*, 357 US 197, (1958) the United States Supreme Court, referring to the cases of *Hovey v. Elliott*, 167 U.S. 409 and *Hammond Packing Co. v. Arkansas*, 212 U.S. 322, made the following relevant observations at 357 U.S. 197, 209:

> "These decisions establish that there are constitutional limitations upon the power of the courts, even in aid of their own valid processes, to dismiss an action without affording a party the opportunity for a hearing on the merits of his case."

POINT IV

THE FEDERAL COURT HAS JURISDICTION TO REVIEW THE STATE COURTS' CONSTITUTIONAL VIOLATIONS.

By statute Congress has made the federal courts the guardian of constitutional rights.

RS Sec 1979, 42 USC Sec 1983
Judicial Code, 28 USC Sec 1343 (3)

Sec 1979 of the Revised Statutes confers a personal right of action at law or in equity for the redress of "any rights, privileges, or immunities secured by the Constitution and laws . . ." Sec 1343 of the Judicial Code confers upon the district courts jurisdiction of suits brought under the authority of Sec 1983.

The pertinent portions of each of the above statutes read as follows:

> Sec. 1983. Civil action for deprivation of rights
>
> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution

and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress. (R. S. §1979).

1343. Civil Rights and elective franchise.—The district courts shall have original jurisdiction of any civil action authorized by law to be commenced by any person:

* * *

(3) To redress the deprivation, under color of any State law, statute, ordinance, regulation, custom or usage, of any right, privilege or immunity secured by the Constitution of the United States or by any Act of Congress providing for equal rights of citizens or of all persons within the jurisdiction of the United States;

Sec 1983 is intended to provide supplemental relief for deprivations of federally protected rights.

Monroe v. Pape, 365 US 167 (1961)

Sec 1983 violations occur when individuals are deprived of rights secured by the federal constitution by persons acting "under color of law." Acting "under color of law" demands state action of some variety, and the requirement is satisfied whenever a state official deprives a person of a federal right, whether he acts in purported accordance with state law or contrary to it.

Monroe v. Pape, 365 US 167 (1961)

Included in the area where Sec 1983 has been utilized to protect individual rights are abuse in the administration of law and abuse of the judicial process.

2 Emerson, Haber and Dorsen, Political and Civil Rights in the United States 1356-2253 (1967)

Since, violation of constitutional rights is basically a question of law rather than fact, a complaint which alleges bare facts concerning state, constitutional violations, not spelled out, with the conclusion that constitutional rights have been violated, gives the federal court jurisdiction to review the state action.

Douglas v. City of Jeanette, 130 F 2d 652, (CA 3, 1942)

In the case at bar, appellants could have brought a separate action under Sec. 1983 to redress the State Court's deprivation of constitutional rights, by seeking the relief of nullifying, voiding

or vitiating the state court action insofar as MCC's Sec. 10(b) action in the Federal court is concerned. Instead, appellants asserted the statute in a more simplified and direct way in the pending Federal Court action, by moving to have the court disregard the order and judgment of the state court because it was made in violation of the constitutional due process and equal protection rights of MCC, its creditors, its sole stockholder and the taxpayers of the state of New York. We submit that the Federal court has jurisdiction to review the State Court's deprivation of constitutional rights.

Judge Brieant determined that what the state court did was not so erroneous as to constitute a denial rising to constitutional dimensions (A28). We contend, as argued in Points II and III of this brief, that Judge Brieant erred.

Judge Brieant determined further, that even if the State Court's denials rose to constitutional dimensions, the Federal Court lacked jurisdiction to review these denials because the proper procedure was to apply to the Supreme Court of the United States from the final State Court determination approving the settlement. We contend that Judge Brieant erred in this respect from several points of view.

First, since the relief afforded by Sec 1983 is supplemental relief for deprivations of federally protected rights, it is not waived or lost by the fact that appellants did not petition for certiorari from the state court determination.

Second, appellants did not have the right to petition for certiorari from the determination of the State Court.

Judiciary Law, 28 USC Sec. 1257 (3)

Sec. 1257 which provides for appeal and certiorari to the Supreme Court from State Court determinations reads as follows with respect to certiorari:

> 1257. State courts—Appeal—Certiorari—Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:
>
> (3) By writ of certiorari, where the validity of a treaty or statute of the United States is drawn in question or

> where the validity of a State statute is drawn in question on the ground of its being repugnant to the Constitution, treaties or laws of the United States, or where any title, right, privilege or immunity is specially set up or claimed under the Constitution, treaties or statutes of, or commission held or authority exercised under, the United States. (June 25, 1948, c. 646, §1, 62 Stat. 929.)

Hence, Sec. 1257 (3) provides for a writ of certiorari from a state court determination only where the validity of a treaty or state or federal statute is drawn in question. Appellants did not, in the case at bar, draw into question a treaty or state or federal statute.

Judge Brieant predicated his determination on the so-called Rooker principle (*Rooker v. Fidelity Trust Co.*, 263 US 413 (1923)) and its application by this court in the case of *Tang v. Appellate Division*, 487 F 2d 138 (CA 2, 1973) (A28). We submit that Judge Brieant erroneously relied upon these cases whose principles have no application to the case at bar. The Rooker principle holds that district courts lack jurisdiction to *review* state court determinations of federal constitutional questions where: (1) the litigant has *voluntarily chosen* the state forum by making application to that forum for the determination of a federal constitutional question, and (2) there is a *right of appeal* to the United States Supreme Court from the state court determination, and (3) the litigant does not question the jurisdiction of the State Court to make the determination of the federal constitutional question.

In the case at bar, appellants did not invoke the jurisdiction of the State Court. On the contrary, they resisted it at every turn of the road claiming that the State Court had no jurisdiction over the matter. Appellants were forced into the State Court because the Supt made his application for approval of the settlement in that court rather than in the Federal Court.

In the case at bar, the State Court was not requested by appellants or anyone else to review any federal constitutional question. The state court was asked by the appellees to approve the settlement made by the Supt and in the course of approving the settlement, violated constitutional rights. Hence appellants are not calling upon the Federal court to review any state court determination of Federal constitutional questions, but rather to

give relief from the State Court's violation of constitutional rights.

Third, appellants did not have any right to appeal to the United States Supreme Court from the State Court determination and Judge Brieant concedes this by his claim not that appellants should have appealed to the United States Supreme Court but rather that they should have petitioned for certiorari. This distinction is basic because the essence of the Rooker principle is that the lower federal courts do not have jurisdiction to review state court determinations of federal questions because only the Supreme Court is authorized to review *on direct appeal* the decisions of state courts determining federal constitutional questions (487 F 2d 138, 141-142).

Finally, appellants did not even have the right to petition for certiorari to the United States Supreme Court.

For all of these reasons we submit that neither *Rooker* nor *Tang* is applicable to the case at bar and Judge Brieant erred when he held that they were.

POINT V

APPELLANTS, AS TAXPAYERS, HAVE STANDING TO LITIGATE THE WASTE OF TAXPAYER MONEY BY THE STATE COMMISSIONER OF TAXATION AND FINANCE

Judge Brieant agreed that when the Supt was appointed Liquidator, he undertook a fiduciary obligation to MCC and its creditors (A18). He held however, that appellants, *as taxpayers* lack standing to litigate the reasonableness and propriety of the settlement even though he assumed "that the public treasury of the State was adversely affected by the failure of the Supt to collect more money from the defendants." (A18).

Judge Brieant's conclusion was based upon several New York cases cited by him at A18 to A19. He cited these cases as standing for the proposition that New York has refused to permit its taxpayers to sue errant officials to prevent waste or review their conduct of public affairs because of generalized damages to the fisc.

By decision of the New York Court of Appeals dated July 2, 1975, the above cases and the New York law refusing to permit its taxpayers to sue errant officials for state waste has been overruled. The Court of Appeals has now adopted the "persuasive reasons" stated by the dissent in *St. Clair v. Yonkers Raceway*, 13 NY 2d 72, 242 NYS 2d 43 (1963) cert den 375 US 970, which was one of the cases relied upon by Judge Brieant (A18-19).

Boryszewski v. Brydges, New York Ct Appeals, July 2, 1975

In *Boryszewski*, the Court of Appeals said on pages 1 to 2 of its uncorrected opinion:

> "Much attention has been devoted in our Court to the determination of which litigants, if any, shall be recognized as having legal capacity to test the constitutionality of a state statute authorizing the expenditure of state moneys. Over vigorous dissents, in *St. Clair v. Yonkers Raceway*, 13 N Y 2d 72, by a 4-3 vote our Court continued the narrow limitation of persons having such capacity to those 'personally aggrieved thereby, and then only if the determination of the grievance requires a determination of the constitutionality' (p. 76). In reliance on holdings in older cases, we then said, 'It seems to us proper 'that the courts of this state have denied the right of a citizen and taxpayer to bring before the court for review the acts of another department of government simply because he is one of many such citizens and taxpayers'.' (p. 76)
>
> Today we no longer think this proper, and accordingly we depart from our holding in *St. Clair*, for the persuasive reasons stated by the dissenters there and for reasons enunciated by dissenters in subsequent decisions. Even the majority opinions in these later decisions reflect some lack of enthusiasm for the *St. Clair* doctrine."

By adopting the "persuasive reasons" stated by the dissenters in *St. Clair*, New York law has now been brought into line with the substantial number of states which not only sanction taxpayers to challenge local action (which prior to *Boryszewski* was permitted in New York), but as well which sanction taxpayers suits challenging state action (*St. Clair v. Yonkers Raceway Inc.*

242 NYS 2d 43, 45). As stated in the *St. Clair* dissent at 242 NYS 2d 43, 47, 48:

> "Of this there can be no possible doubt. The State has a vital concern, its People a deep interest, in seeing to it that the provisions of our Constitution are enforced, and unconstitutional expenditures of state funds prevented. Neither logic nor policy demands that the judiciary stay its hand and dismiss the action simply because the proceeding happens to be initiated by a vigilant and civic-minded taxpayer following official inaction. It hardly seems consonant with the Constitution itself that the enforcement of its provisions should have to turn on the meaning ascribed to it by members of the executive or administrative branch of government or on whether they choose to assert themselves."
>
> "It is self-evident that the denial of standing to a taxpayer will in most instances prevent any challenge to an expenditure of state funds as violative of the Constitution." . . .
>
> "In sum—although the Legislature could, of course, remove the taxpayer's disability at a stroke, enforcement of the Constitution should not depend upon the will of the legislative branch any more than on that of the executive. The apathy of the average citizen concerning public affairs has often been decried; under the court-made rule now reaffirmed, it is being compelled. I would change the rule."

The rule has now been changed by *Boryszewski.*

POINT VI

APPELLEES SHOULD BE ENJOINED FROM MAKING INEQUITABLE USE OF THE STATE COURT JUDGMENT

Appellants contend that the order and judgment of the State Supreme Court should be deemed a nullity for lack of jurisdiction and violation of substantial constitutional due process and equal protection rights.

We also contend that it is not necessary for this court to go

that far. The same result can be obtained by enjoining the parties from using the State Court judgment as a defense in the Federal action for the purpose of having the case dismissed without a hearing on the merits as to the fairness of the settlement.

> *Breswick v. Briggs*, 135 F. Supp. 397 (SDNY 1955) app dismissed No. 23661 (2d CA, Jan. 23, 1956) cert. den 351 US 697 (1956)

Breswick is directly in point. The court enjoined the defendants from using as a defense to a stockholders' derivative action in the Federal Court, a judgment of settlement obtained in a similar action in the State Court, on the ground that the judgment had been inequitably obtained because certain plaintiffs had been excluded from the negotiation of the settlement agreement upon which the State Court judgment was based.

In the case at bar, all proceedings up to the time of the application for leave to settle, took place in the Federal court before judges familiar with Sec 10(b) proceedings and in particular, Judge Brienat, to whom the case had been assigned. Judge Brieant was familiar with the case in all its rammifications.

When the time for settlement arrived, the appellees made the application for consideration of the fairness of the settlement on the merits, not to Judge Brieant, but to the State Court Justices who had no familiarity with the Sec 10(b) case, and no experience whatever with respect to Sec 10(b) cases. It does not make sense that the appellees should have had the right to foreclose Judge Brieant from consideration of the settlement on the merits. This court should hold that appellees had no right to do this.

CONCLUSION

Appellants have not addressed this brief to the merits of the settlement because the failure of Judge Brieant to pass thereon, and his assumption "that the settlement to be made is improvident and inadequate, and that movants are aggrieved thereby", forecloses consideration of the merits by this court.

Judge Brieant erred when he determined that the State Court had jurisdiction to determine the merits of the settlement; when he determined that no federal interest exists which required consideration of the settlement on the merits by the federal court; when he determined that the state court did not deprive MCC, its creditors, its sole stockholder, and the taxpayers of the state of New York of constitutional due process and equal protection of the laws; when he determined that the federal court had no jurisdiction to determine the constitutional questions raised by the appellants; when he held that the appellants, as taxpayers, have no standing to litigate the reasonableness and propriety of the settlement; and when he determined that the State Court approval of the settlement of MCC's exclusively Sec 10(b) action justified a dismissal of the federal action without any hearing on the merits in the Federal court.

The determination below should be reversed.

Respectfully submitted,

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Dated: New York, N.Y.
August 22, 1975

STATE OF NEW YORK)
: SS.
COUNTY OF RICHMOND)

ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 22 day of August , 1975 deponent served the within ~~Appendix~~ Brief upon JOSEPH J. MARCHESO, 1251 Ave. of the Americas, New York, N.Y. 10020; JACOBS, PERSINGER & PARKER, 70 Pine St., New York, N.Y.; WINTHROP, STIMPSON, PUTNAM & ROBERTS, 40 Wall St., New York, N.Y.; SULLIVAN & CROMWELL, 48 Wall St., New York, N.Y.; SEITS & SHAPIRO, 110 East 42nd St., New York, N.Y.; JILLSON, ~~KEES~~ BEDFORD & HOPPEN, 115 Broadway, New York, N.Y.; NEW ENGLAND NOTE CORP., c/o Clerk of the Court, U.S. Dist. Ct., U.S. Courthou-e, Foley Sq. New York, N.Y. 10007; STANDISH T. BOURNE, JR., R.D. No. 2, Allentown, Pa. ~~18~~ 18103; JOHN F. SWEENEY, c/o Clerk of the Ct., U.S. Dist. Ct., U.S. Courthouse, Foley Sq., New York, N.Y. 10007

~~attorney(s) for~~ in this action, at

the address(es) designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

.....
ROBERT BAILEY

Sworn to before me, this
22 day of August , 1975.

William Bailey

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976